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Supreme Court of the United States

October Term, 1944

No. 645

IN THE MATTER

OF

MECCA TEMPLE OF THE ANCIENT ARABIC ORDER OF THE NOBLES OF THE MYSTIC SHRINE

Debtor

WILLIAM DARROCK

Creditor-Intervenor-Respondent

MECCA TEMPLE OF THE ANCIENT ARABIC ORDER OF THE NOBLES OF THE MYSTIC SHRINE

Debtor-Petitioner

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR CREDITOR-INTERVENOR-RESPONDENT IN OPPOSITION

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(*Figures in parentheses, except as otherwise indicated, refer to the folios of the Transcript of Record.*)

Opinions Below

The opinion of the Referee is found at pages 38-44 of the Transcript of Record.

The opinion of the District Judge is found at pages 45-49 of the Transcript of Record.

The unanimous opinion of the Circuit Court of Appeals is reported in 142 Fed. (2d) at pages 869 *et seq.* and is found at pages 73-79 of the Transcript of Record.

Jurisdiction

The order of the Circuit Court of Appeals reversing the judgment of the District Court and reinstating the order of the Referee, was entered on July 31st, 1944 (R. p. 80).

The jurisdiction of This Court is being invoked under §240(a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A. §347[a]).

Questions Presented

Two questions are presented,—

(a) Whether the Referee's dismissal of the petition on his own motion was improper, although respondent herein as intervening-creditor also pressed for such dismissal; and

(b) whether the petition was correctly dismissed on the merits.

Statutes Involved

Bankruptcy Act:

Section 1, subd. 8
Section 21a
Section 77b
Section 106, subd. 12
Section 334
Section X
Section XI

Statement

The debtor herein filed a petition under §322 of Chapter XI of the Bankruptcy Act. The Referee, to whom this matter ultimately was referred by the District Court, *sua sponte,* issued an order that the debtor and the Securities and Exchange Commission show cause why the petition should not be dismissed. After several hearings at which the Commission appeared informally and respondent, as intervening-creditor pressed for dismissal, the Referee finally dismissed the petition, being of the opinion that fair and equitable relief for the creditors of the debtor could be obtained only by a proceeding under Chapter X of the Bankruptcy Act.

The District Court for the Southern District of New York, in an order made in December, 1943, reversed and vacated the order of the Referee and directed the Referee to proceed with the petition of the debtor in accordance with the provisions of Chapter XI of the Bankruptcy Act (6-9).

The intervening-creditor Darrock, appealed to the Circuit Court of Appeals which, with a unanimous opinion, reversed the order of the District Court.

By its petition for a writ of certiorari, petitioner seeks to review the order entered pursuant to that unanimous opinion of the Circuit Court.

Argument and Statement of the Facts

On July 20th, 1943, the debtor filed in the United States District Court for the Southern District of New York, a petition and schedules for arrangement pursuant to Sec. 322 of Chapter XI of the Bankruptcy Act (160-210). On the same day, two orders were entered on the debtor's petition, one continuing the debtor in possession of its property, and the other staying the intervening creditor-respondent herein.

The debtor organization has some 2800 members (152) and the bondholders, the only creditors of the organization, number some 1834 (176). It maintains an executive office, has an interest in two pieces of real estate (18), owns two cemetery plots (182), has accounts receivable (dues from members) (184), maintains a number of bank accounts (186), has an annual income in excess of $50,000 (201), disburses $10,000 a year for salaries of secretaries, publishes a magazine quarterly, and owes on unsecured claims (principal and interest) an amount approximating $1,200,000 (194).

By the submitted plan of arrangement, the debtor proposed to pay to all of the bondholders ten percent of the principal amount of the outstanding bonds in installments of 1% per year, without interest (163), approximately $7,630 per year for ten years (229).

On August 9th, 1943, the Referee, to whom the matter had been referred, signed the order of dismissal aforementioned (34-38), and on said date, rendered a full opinion and also made findings of fact and conclusions of law (112-132), in substance to the effect, that adequate, just and equitable relief for the creditors of the debtor cannot be obtained by a proceeding under Chapter XI and that such relief can only be obtained by a proceeding under Chapter X.

This, the District Judge reversed and vacated and he directed the Referee to proceed with the petition of the debtor in accordance with the provisions of said Chapter XI of the Bankruptcy Act (69). The District Judge in his opinion (pp. 45-49) stated that he disagreed with the Referee, questioned his authority to dismiss the petition and held that the debtor was of a different type of corporation from the one involved in *Securities and Exchange Commission* v. *U. S. Realty & Improvement Co.*, 310 U. S. 434 (hereinafter referred to as the *U. S. Realty* case), and therefore was not barred from seeking relief under Chapter XI of the Bankruptcy Act. This reversal was followed

by an appeal to the Circuit Court of Appeals by William Darrock, said creditor-intervenor and the Circuit Court reversed the District Court in a unanimous opinion (pp. 73 to 79) and directed that the order of the Referee be reinstated (235-236).

The Referee had found that it was the duty of the Court, *sua sponte,* when it believed its jurisdiction to have been imposed upon, to inquire into the facts and act in accordance therewith (citing authorities). The Referee in his opinion (pp. 38-43) went into a discussion of the liabilities, the nature of the creditors and so forth.

The Circuit Court held that this was an insolvent membership corporation of some 2800 members; that its annual income from dues was approximately $50,000 and that it had additional small miscellaneous receipts of some $2500 while its disbursements ran to some $10,000; that it owed in principal and interest on debenture bonds, approximately $1,200,000 on which no interest had been paid for upwards of the past ten years; that these bonds were originally sold exclusively (except for the sum of some $20,200 of principal sold to architects) to members of the debtor corporation and to other fraternal organizations to which the members of the debtor also belonged; that "through inheritance, assignment and sale, however, the bonds have so changed hands that present holders are 1834 in number, scattered throughout the country, and not necessarily all members of the debtor"; that the creditor-intervenor herein was not a member of the debtor or of any fraternal organization to which the debtor's members belonged and owned $1200 face value of these bonds; that the creditor-intervenor "pressed for a dismissal", after the Referee had initiated the proceedings which resulted in the dismissal of the petition.

According to its opinion, fair and equitable relief for the creditors of the debtor could be obtained only by a proceeding for reorganization under Chapter X of the Bankruptcy Act and "a Referee in bankruptcy clearly has

the power *sua sponte* to dismiss a petition for an arrangement under Chapter XI and relegate the debtor to reorganization proceedings under Chapter X'' (225-226, pp. 75-76).

The Circuit Court discussed the debtor's proposed plan and its obvious inequity, and referring to the debtor's income of ''well in excess of $50,000, while disbursements total less than $15,000'', noted the absence of ''explanation of the use to which the balance of the receipts is being put. Some explanation is surely due the creditors before they should be obliged to accept ten cents on the dollar for their principal and nothing at all for their long overdue interest.'' The result the Court denominated ''palpably unjust to the unsecured creditors of a corporation whose income appears to exceed its authorized expenditures by nearly $40,000 yearly. These facts by themselves suggest that the plan merits condemnation under Bankruptcy Act, §366(2) which states that the Court shall confirm an arrangement only if it is convinced that 'it is for the best interest of the creditors' '' (229-230).

The total number of bondholders, the wide area over which they are spread, make it, as the Circuit Court said, unlikely that there is any definite accord in this matter. ''Indeed'', said the Circuit Court, ''it is more probable that many (creditors) do not even know of the pendency of these proceedings and that many who have been informed, suffer from a grave lack of adequate information as to the true state of affairs. For this situation, a petition under Chapter X, is again the only fair solution'' (231).

POINT I

The unanimous decision of the Circuit Court sought to be reviewed is in accord with This Court's decision in the *United States Realty* case.

This Court in the *U. S. Realty* case (*supra*) has made an exhaustive comparison and analysis of the respective purposes of and merits of proceedings under Chapters X and XI and as the Circuit Court stated: "there is little which can be added to the criteria set forth" (227). There may be borderline cases, but "especially persuasive here, is the nature of the debtor's financial structure which is such that if a reorganization under Chapter X is not required the interests of an objecting creditor like appellant (respondent here) are not likely to be adequately protected" (228).

Chapter X establishes safeguards in the interest of thoroughness and disinterestedness. A trustee appointed by the Court devises the plan and not the debtor. The trustee, Securities and Exchange Commission and the Court carry on the debtor's affairs. Acceptances of the plan cannot be solicited until after the Court's approval of it. It is particularly applicable to a debtor corporation with widely scattered security holders and debts divided into small units, such as bonds and debentures.

In the case at bar, indisputably there are approximately 2800 members of the debtor's organization. There are some 1834 bondholders from New York to California (176-177), men, women, estates of decedents, corporate and fraternal organizations and partnerships (177), holding securities (a form of debenture bond) of the debtor, in denominations of $100, $500, and $1,000, past due, which, exclusive of interest, exceed some $750,000 par or face value.

In a footnote to the *U. S. Realty* case appears the following:

> "The basic assumption of Chapter X * * * is that the investing public disassociated from control or active participation in the management, needs impartial and expert administrative assistance in the ascertainment of facts, in the detection of fraud and in the understanding of complex financial problems" (citing authorities).

These 1834 creditors to whom over a half million dollars exclusive of interest is owed, are entitled to have a "fair, equitable and feasible" plan of reorganization or arrangement, not something slipped through secretly and unknown to practically all of them.

For the creditors to obtain such "fair, equitable and feasible" adjustment of their claims, the following seem vital:

1. A thorough examination of competent witnesses, such as the officers of the debtor organization. The accountants and auditors who prepared financial reports for the organization would likewise be valuable witnesses. These men should be examined among other things, as to the assets of the debtor, as to where its fortune has disappeared, as to the ways and means of economical and businesslike administration of the debtor. Such a thorough examination of these witnesses must be conducted by a disinterested person, not by the attorney for the debtor, but by the attorney for a Trustee. This is impossible under Chapter XI.

2. The fullest disclosure under oath of all assets of the debtor no matter how held, whether by dummy, subsidiary, affiliates, trustees or otherwise and of its income. This is impossible under Chapter XI.

3. A reorganization of the debtor so that it will be operated on an economical and sound business basis. Useless expenditures and extravagances and possibly private gains must be eliminated. There must be a frank disclosure of the monies received from dues, from initiations, from rents, from the sale of cemetery plots, from bequests and devises, of the disposition of non-income and income-producing real estate, of the amount of dues receivable and collectible. This is impossible under Chapter XI.

A disinterested trustee running this organization in a businesslike manner, should ascertain how many of these seven hundred odd thousand dollars face value of bonds can be turned in gratis and do not any longer fairly constitute an obligation. This could be properly dealt with if the Court were informed by a disinterested trustee just how much is owing to persons who want their money. This is impossible under Chapter XI.

By Chapter XI, everything is sacrificed to speed and economy, but, upon its improper application, it is a false economy. The debtor submits a plan and every phase of the procedure falls under his control. The creditors are often not even notified, because, an enterprising debtor can corral a sufficiency of friends and their acceptances of the plan, before even filing his petition.

> "The arrangement may be consummated at the conclusion of a single creditor's meeting. The Court in passing upon the arrangement is without the benefit of investigation and study by the Trustee or Commission."
>
> *U. S. Realty, supra.*

Chapter XI does not apply to the debtor herein. It is peculiarly adapted to the composition of the debts of small business men. As was stated in a footnote to the *U. S. Realty* case, Chapter XI was sponsored by the National Association of Credit Men and other groups of creditors'

representatives. "Their business of representing trade creditors in small and middle sized commercial failures is an important factor in the background of the Chapter."

Chapter X "sets up a special procedure for the protection of widely scattered security holders and the public, * * * while Chapter XI * * * is peculiarly adapted to the speedy composition of debts of small individual or corporate businesses" (*U. S. Realty, supra,* at p. 447).

> "But granting the jurisdiction of the Court, the question remains of the propriety, in the circumstances, of its order retaining jurisdiction, and of the extent of its duty to go forward with the proceeding under Chapter XI in the face of the contention that Chapter X alone affords a remedy adequately protecting the public and private interests involved. The answer turns not on the court's statutory jurisdiction to entertain a proceeding under Chapter XI, but on considerations growing out of the public policy of the Act found both in its legislative history and in an analysis of its terms, and of the authority of the court clothed with equity powers through its power to withhold relief under Chapter XI when relief is available under Chapter X, which is adequate and more consonant with that policy."
>
> *U. S. Realty, supra,* at pp. 447-8.

Justice and equity require not "a speedy termination" which the debtor prays for, but a thorough examination of competent witnesses by a disinterested trustee into the acts, conduct, properties, liabilities and financial condition of the organization and a plan for an efficient and economical future administration, for the protection of the best interests of the creditors and the members, all of which relief Chapter X is intended to and does afford, and Chapter XI does not.

If the securities in this case are not held by the public, it is hard to imagine a case in which such would be the fact for, while the bonds are not actively traded in since they have been in default as to principal and interest for many years, they can be purchased in over-the-counter houses (45) and are concededly held by many persons and organizations, not members of the debtor or of any fraternal organization with which it might be directly or indirectly identified and who extend across the land.

If ever there was a case in which "the investing public dissociated from control or active participation in the management needs impartial and expert administrative assistance * * *", this is one. The contention of the debtor that this is virtually a private issue and that there is no public interest to be protected is unworthy of credence. While this might conceivably have been valid in 1922, as the Circuit Court of Appeals said:

> "* * * it is patently ridiculous now. The bonds are bearer bonds and have passed from hand to hand for twenty-two years; there are existing over 1,800 bondholders (as compared to only 900 in the United States Realty case), and these are scattered throughout the country. In this connection, the $20,200 in bonds originally issued to the firm of architects of the original building may also be recalled. Surely it cannot be said in the light of such facts that there is no public interest in the bonds. There is an obvious and direct divergence in interest between the nonmember creditors, who desire only repayment, and the member creditors, who are necessarily anxious also to free their fraternal organization finally from the load of debt it has been carrying." (232-233, p. 78)

It is respectfully submitted there is no occasion for This Court to grant the writ so that it may explain or limit or define its decision in the *U. S. Realty* case, *supra*, for, as the Circuit Court of Appeals well stated (227):

"Since the Supreme Court in the *United States Realty* case, *supra,* has made an exhaustive comparison and analysis of the respective purposes of and merits of proceedings under the two chapters, there is little which can be added to the criteria set forth there".

POINT II

***Hoile et al.* v. *Unity Life Insurance Co.*, 136 Fed. (2d) 133, cited by petitioner in its Point III, is not in point.**

Petitioner's said Point III is specious.

Petitioner propounds a Point III which suggests that, by the decision of the Circuit Court herein, petitioner is being "compelled" to file a "voluntary petition" under Chapter X. It cites the *Hoile* case, *supra,* as holding that involuntary proceedings under said Chapter and against a fraternal organization are forbidden and then, by an assumption that "voluntary" proceedings are being "compelled", it suggests that a prohibited "involuntary" proceeding is being induced.

We respectfully submit that all of this is sophism. Petitioner may or need not file voluntarily under Chapter X, as it pleases. No one exerts any restraint one way or the other upon it, neither the Circuit Court in the decision herein, nor anyone else.

The *Hoile* case merely holds that involuntary Chapter X proceedings may not be maintained against fraternal organizations; that voluntary proceedings under that Chapter may be maintained by fraternal organizations and that "reorganization proceedings under Chapter X cannot be resorted to for the mere purpose of liquidation." We fail to see any relevancy whatsoever in the *Hoile* case.

POINT III

On the question of the right of the Referee *sua sponte* to initiate the proceedings for dismissal, there is no conflict between the Circuit Courts in the Second and Seventh Circuits.

The *Frank E. Walsh* case, 256 Fed. 653, is so totally inapplicable (relating as it does to objection to a bankrupt's discharge) that to discuss it would unduly prolong this brief.

True, no party in interest filed any petition upon which the order to show cause, issued by the Referee in the instant case, was based. The District Court questioned the right of the Referee to proceed in this matter, but did not base its decision of reversal upon it (142, 143). The Circuit Court considered the matter and said he had such right (p. 75). On this matter, the Circuit Court said in its opinion (pp. 75-6):

> "First, a referee in bankruptcy clearly has the power *sua sponte* to dismiss a petition for an arrangement under Chapter XI and relegate the debtor to reorganization proceedings under Chapter X. The District Judge read Securities and Exchange Commission *v.* United States Realty & Improvement Co., *supra*, to permit the application of §146 of the Bankruptcy Act—dealing with want of 'good faith' in the filing of a petition for reorganization, to be passed upon by 'the judge' under §141—to apply to a proceeding under Chapter XI, and thus to support the inference that action must be by the judge. But what the Supreme Court actually decided was that a bankruptcy court, as a court of equity and in the exercise of its equity powers, could determine under Chapter XI the adequacy of the relief afforded by that Chapter, in the same manner as it can in reorganization

proceedings under the specific permission of §146. 310 U. S. at pages 455-456. Hence the 'bankruptcy court,' rather than the 'judge,' has this equitable power; and since the Bankruptcy Act, §1(9), includes the referee within the meaning of the term 'bankruptcy court,' the referee had the power to dismiss here."

To all of which must be added an emphasis on the fact that, though the Referee initiated the order to show cause, the creditor-intervenor-respondent, to quote the Circuit Court, "pressed for dismissal" (224).

Conclusion

It is respectfully submitted that

(a) There is nothing novel in the Circuit Court's ruling nor is there conflict among the Circuit Courts;

(b) The relief available to the debtor under Chapter X is adequate and more consonant with the public policy of the Bankruptcy Act and more likely to give fair, equitable and feasible relief to the 1834 creditors scattered throughout the United States with claims totalling about $1,200,000, than the "summary procedure" the debtor seeks under Chapter XI;

(c) There are no doubtful aspects of the *U. S. Realty* case which require review or refinement by This Court; there is little which can be added to the criteria set forth by This Court in that case.

It is therefore respectfully submitted that the petition should be denied.

Respectfully submitted,

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